

ECONOMIC AND FISCAL UPDATE 2019

December 16, 2019

Federal government facing larger deficits—with more promises to fulfill

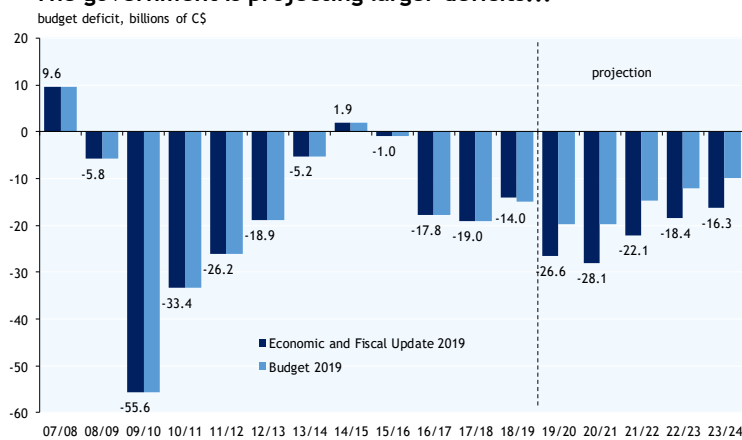
- Projected deficit for the current fiscal year revised up to \$26.6 billion from \$19.8 billion in Budget 2019
- Actuarial changes account for much of the increase, limiting the government’s fiscal room
- Personal income tax relief costs \$3 billion next fiscal year
- Key debt-to-GDP ratio will move higher and then decline only gradually

Today’s Economic and Fiscal Update shows a more challenging fiscal starting point for the new minority Liberal government. That’s not because of a worsening economic backdrop—in fact, nominal GDP growth forecasts were revised slightly higher. Rather, a restatement of pension obligations increases the government’s deficit profile by an average of \$5.6 billion over the next five fiscal years relative to Budget 2019. Along with promised income tax relief and some one-off spending items, the government’s budget shortfall is significantly higher than previously projected. Actuarial changes or not, that means the government could find it more difficult to deliver on its other campaign pledges while still shrinking its debt load as a share of GDP. Moreover, any downside surprises on GDP could force the government to abandon their commitment to reducing the debt-to-GDP ratio.

Delivering on a key election promise...

The main policy change in today’s update delivers on a campaign pledge to reduce income taxes for most Canadian households. As announced last week, an increase to the Basic Personal Amount will be phased in over four years, and once fully implemented, will (for example) lower a single individual’s tax bill by nearly \$300 per year and a dual-income couple’s by close to \$600. The increase in the BPA will be phased out for higher-income individuals but will reportedly cut taxes for nearly 20 million Canadians. The cost of that measure, in the form of lower income tax receipts, rises from \$3 billion next fiscal year to \$6 billion in FY 2023/24.

The government is projecting larger deficits...



Source: Department of Finance, RBC Economics Research

Some of that cost is offset by higher revenues relative to Budget 2019. Revenues are expected to be \$1.7 billion higher in the current fiscal year amid stronger personal and corporate income tax receipts. (Growth in nominal GDP, a broad measure of the tax base, was revised up by 0.2 percentage points in both 2019 and 2020.) That carries through the projection, with revenues marked up by nearly \$4 billion in FY 2023/24.

Other policy actions since Budget 2019 were relatively modest. A dividend agreement with Newfoundland and Labrador costs \$1.9 billion in the current fiscal year, and support for dairy farmers (to address challenges arising from the CETA and CPTPP trade deals) has a price tag of \$354 million. Starting in FY 2020/21, the government is booking \$1.5 billion in annual savings from a “comprehensive review of government spending and tax expenditures.”

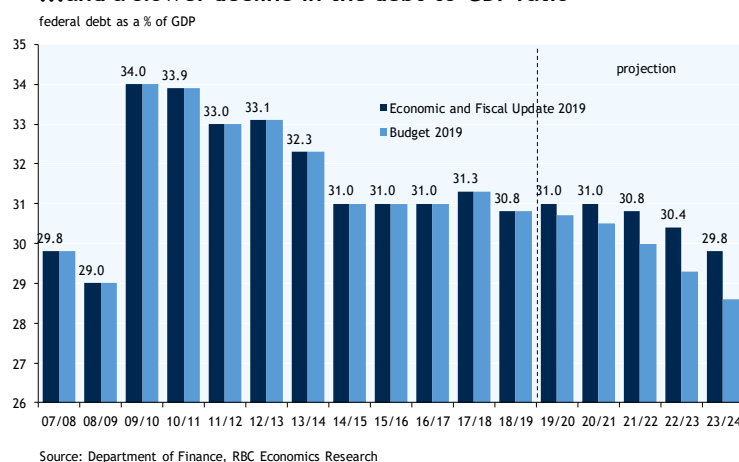


...but with less room for other measures?

In 2018, the government changed the way it calculates the present value of employee pensions and future benefits. The new methodology provides a more accurate and up-to-date picture of those liabilities, but also makes them more sensitive to changes in interest rates. That was on full display in today's update, with a lower interest rate outlook resulting in larger estimated obligations and thus higher program expenses relative to Budget 2019. The government is exploring whether reporting its "operating balance", which would show such actuarial changes as a separate line item, would provide a more accurate picture of changes in its financial position. But as the figures are reported now, the hit to the government's bottom line is \$4.9 billion in the current fiscal year and \$7.6 billion next fiscal year.

Actuarial change or not, that means less fiscal room than previously thought. The budget deficit is now projected to jump to \$26.6 billion in the current fiscal year from \$14.9 billion in FY 2018/19. That's substantially higher than the \$19.8 billion shortfall envisioned in Budget 2019. The deficit rises even further, to \$28.1 billion, in FY 2020/21. For comparison, the Liberals' election platform showed a \$27.4 billion shortfall next fiscal year, and that's with billions of dollars of "new investments" beyond today's BPA increase. If the government remains committed to reducing its debt load as a share of GDP, it might have to prioritize some of that spending. Today's projections show the debt-to-GDP ratio rising to 31.0% in FY 2019/20, and not falling back to last year's level until FY 2021/22. And as usual, these projections assume steady economic growth. Any economic downturn in the coming years would cause debt-to-GDP to rise substantially, as it did a decade ago. Canada's debt-to-GDP ratio is still 2 percentage points higher than it was prior to the 2008/09 recession.

...and a slower decline in the debt-to-GDP ratio



Projections from Economic and Fiscal Update 2019

billions of dollars	Projection					
	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
Budgetary transactions						
Budgetary revenues	340.1	352.3	367.2	381.8	395.9	411.9
Program expenses	340.8	353.6	361.0	370.0	379.8	389.1
Public debt charges	24.4	23.7	25.3	27.3	29.5	31.5
Total expenses	365.2	377.4	386.3	397.2	409.2	420.5
Adjustment for risk						
Budgetary balance	-26.6	-28.1	-22.1	-18.4	-16.3	-11.6
Federal debt	713.2	741.4	763.4	781.8	798.1	809.7
Per cent of GDP						
Budgetary revenues	14.8	14.7	14.8	14.8	14.8	14.8
Program expenses	14.8	14.8	14.6	14.4	14.2	14.0
Public debt charges	1.1	1.0	1.0	1.1	1.1	1.1
Total expenses	15.9	15.7	15.6	15.4	15.3	15.1
Budgetary balance	-1.2	-1.2	-0.9	-0.7	-0.6	-0.4
Federal debt	31.0	31.0	30.8	30.4	29.8	29.1

Source: Department of Finance, RBC Economics